RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

P. O. Box 1759, La Jolla, California 92038
Minimum of 26 Letters per year – $185 Annually
Registered with the Securities and Exchange Commission

March 23, 1983 **Letter 857**

Mar. 11, DJIA 1117.74; PTI 1542; A-D ratio –15.86
Mar. 18, DJIA 1117.74; PTI 1541; A-D ratio –16.14

THE MARKET: In the last Letter I included a little notation on the Primary Trend Index chart. The note said, "Getting awfully extended." I also stated that the PTI had risen on 13 out of the last 14 weeks, a record. So it really wasn't a case of whether the market was overdue for a correction, it was a case of how big a correction.

One of the items I watch for during any stock market movement (up or down) is the amount of technical resistance to the move. In a powerful movement almost all the averages and indicators get in gear. In a mild movement you see resistance, you see divergences, you see various indicators "fighting" the action. And this is one of the things the PTI gauges.

Now it's true that a market movement can start slowly amid much resistance, and then somewhere down the line all resistance gives way and we see an explosion on the upside (if it's a bull move) or a waterfall on the downside (if it's a bear move).

So given the thesis that this market is tired and that it wants to correct, what do we have now? Between March 3 to 7 just about everything (including all the averages, the PTI and the A-D ratio) confirmed on the upside–to new record highs. Since then it's been a process of erosion, with averages and indicators sliding off–reluctantly.

I am attaching top priority to the PTI now. The long, rising trendline from the August low comes in at around 1512 as you can see on the daily chart. A violation of this trendline would indicate that the secondary trend of the market had turned bearish. Below the trendline stands the 21-week moving average, which is now at 1526. Breaking below that trendline, the PTI would be shouting "extreme caution" or even "danger."

There is no doubt that the market has been over-bought and extended. Many leading analysts are now calling for a 150 to 200 point correction. I have no stubborn scenarios for the period ahead, but I must say that gold's action bothers me. If gold is saying "stability and no inflation" that's fine. But if gold is saying "deflation" then we've got problems coming up–BIG problems indeed.

THE PICTURE: I sit here, and I wonder, "Why do I write anything about the debts of this nation? Why do I harp on defense? Why talk about the farmers and commodities when only a fraction of my subscribers buy the beans or sell cotton short? Why do I even mention foreign markets when probably 90% of my subscribers never owned a foreign issue?

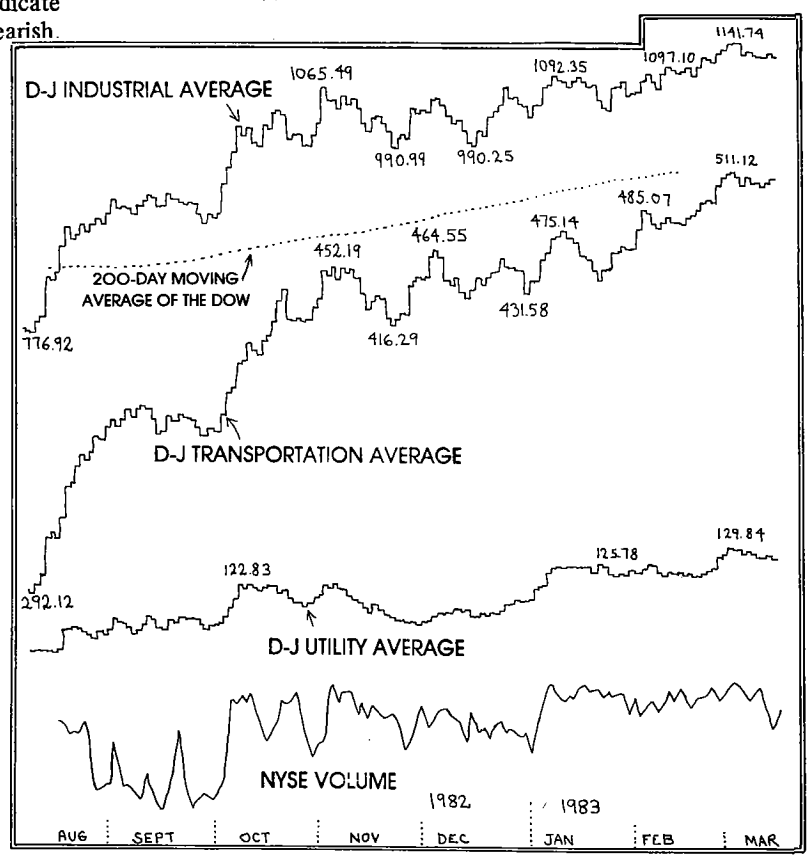
The fact is that it would be a lot easier to simply follow the markets. I could mail out a one-page bi-weekly letter with a box, a box containing say, the leading averages the bond average, the advance-decline ratio and 10 to 15 sundry indices. Then I could simply check each one bullish or bearish–and I could include a list of stocks that I think could double or triple (or in a bear market they would be calculated to go down the tubes).

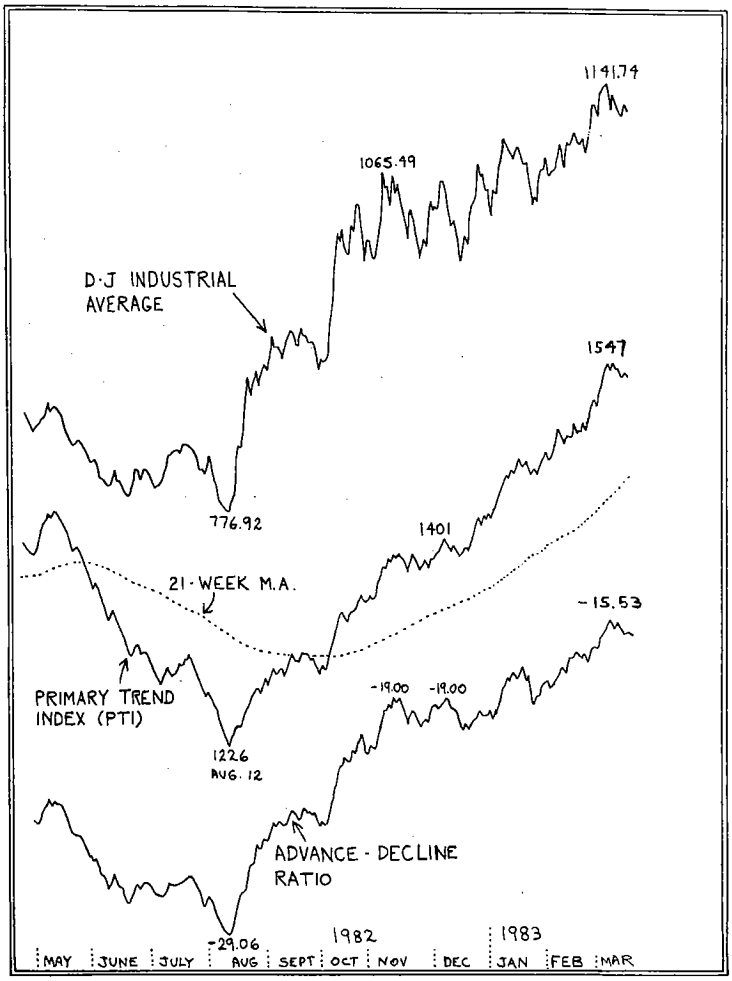
THOUGHTS: I want to present some of my current thoughts (and, of course, these thoughts have been colored greatly by the action of the various markets). First, I'm thinking that this nation is (at least for a year or so) going to squeeze by without hyper-inflation or deflation. I believe that we could be going into a period of what I term "lop-sided stability." When I say lop-sided I mean that there are going to be a lot of weak spots and strong spots (it's not going to be uniform prosperity). But somehow we are going to move into a period of relative stability.

I don't think that the oil price structure is going to totally collapse. I don't think we're going to see a series of catastrophic defaults by less-developed nations. Perhaps somehow the huge debts of the various LDC nations are going to be "sanitized" or rescheduled or otherwise handled. And lo and behold, the stock market (so far) has liked it.

I note that the newspapers and magazines are still full of crisis headlines, and the "end of the world" scenario is still selling well. But I don't think that scenario is going to materialize this year. I just don't think so.

What about business? There is unquestionably a pick-up now. It's a lop-sided pick-up with big areas such as steel in the doldrums (the steel industry is down and almost out), but other industries





are rising. Whether the whole country can live on selling information to itself I don't know, but we're certainly headed in that direction. And the banks. . . . the banks (thanks to the Fed) are swimming in money, they are flooded. In most cases, it's a question of finding enough credit-worthy customers to lend the money to. And this liquidity will gradually sift through the economy.

Next, have you ever thought that the rise of frenzied commodity trading, options, futures, technical systems, hot-line newsletters–all this adds up to one thing? And that one thing is ***trading***. Investors have been burned so many times in wide-swinging markets that trading is now taken as an act of faith. "Buy and hold stocks? You've got to be out of your skull, fellah, I mean I trade 'em and stay loose."

Well my instinct tells me that the trading syndrome is not going to be the correct one in the several years ahead. I'm thinking that the old "buy and hold" method is where it's at. I've been talking about the no-load funds for quite a while, and I have felt that this is the place to be (in conservative quantities). And one reason I like the no-loads is that it's easy to stay with them on the long side. Individual stocks tend to bounce and sink, but the no-loads are usually steadier–and I find them easier to hold.

I've been trying to put the action of the stock market together with the sudden swooning in the precious metals and the relative stability in the bond market. To my mind, it adds up to this: some kind of stability in the economy with no inflation–yet no deflationary collapse. That's a tall order and a contrary opinion. But I believe that's what the markets may be telling us. And the more contrary and impossible it seems, the more probable it is that this scenario will unfold.

TARGET: Point & figure charting is both useful and instructive. I've used it for decades. One of the more interesting facets of P & F charting is that it can prove theoretical targets or counts on both the upside and the downside. One of the count methods is based on the "initial impulse" or the "send-off". This type of count is grounded on the theory that the amount of energy of the initial thrust of a move–tells you a great deal about the ultimate extent of a move.

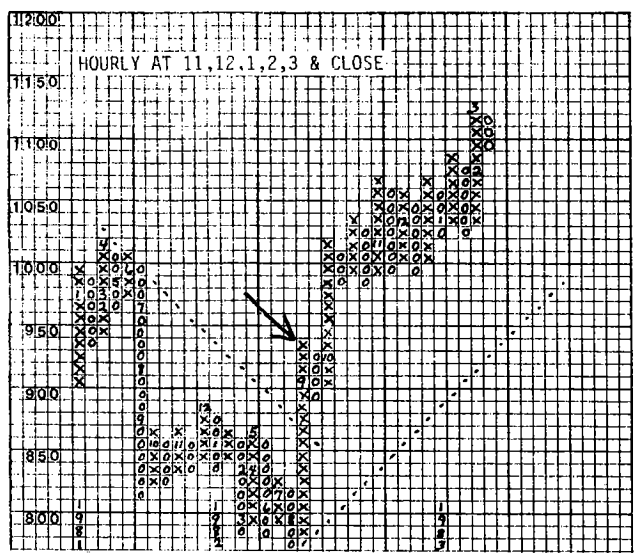
I can illustrate this with two items. The first is the P & F chart of my own PTI. In earlier Letters I stated that the huge "head-and-shoulders bottom" in the PTI easily allowed for a rise in the PTI to all-time highs. The new highs in the PTI have, of course, now been achieved.

The original upward thrust from the 1228 bottom on the PTI chart–that original thrust was 19 boxes. Each box equals 4 points, and since this is a three-box reversal chart the 4 points are multiplied by 3. Thus the upward projection, based on the original 19 box rise was for 228 points. Adding 228 to the extreme low (from which the thrust began) gives 1456. That was the upside target.

Significantly, this upside target (which seemed far-fetched at the time) has now been far surpassed. I say this is significant because in a bull market the upside target is often bettered. Thus, the fact that 1456 was bettered by the PTI is a definite argument in favor of a big bull market.

Now turn to the P & F chart of the Dow. This is a 10 x 30 chart which means that each box on the chart equals 10 points and only advances or declines of 30 points or more are registered on the chart.

DOW-JONES INDUSTRIAL AVERAGE (10 × 30)



The initial upward thrust from the bottom amounted to 16 boxes. Since each box is worth 10 points, that's 160 points. Now we multiply that by 3 since this is a three-box (30-point) reversal chart. That gives us a target of 480 points measuring from the 780 bottom. So 480 added to 780 provides an ultimate

target of 1260 for the Dow. Based on the initial thrust, we can now say that the Dow has enough energy to rise to the 1260 level (of course, if this is to be a super bull market the 1260 can be surpassed).

How accurate are these point & figure counts? I would say that counts in the direction of the primary trend tend to be fairly good, whereas counts in the opposite direction (in other words, counts based on corrective moves) tend to be inaccurate. In strong primary movements, the counts tend to be surpassed by the actual price action.

What is the time period for these counts? There is no time limit on the counts. A count may be fulfilled in a month or in five years. By the same token, there may be many corrections before a count is finally realized.

How is a target or count countermade? In other words, when is a count invalid? I would say that occurs when in a bull market an opposing top is formed and that top then breaks down. But the top must be of sufficient size to be deemed a primary top. The exact reverse is true for a bottom in a bear market.

INVESTMENT POSITION: If you haven't done your buying by now–hold off. The markets are tired, and the stock market still hasn't responded fully to the gold smash. But it could. This is a time to be conservative. Money rates have been creeping higher with the 91-day bills now yielding an attractive 8.30% (thus, a very high real return considering we have almost no inflation today).

I guess I should put it this way. I really don't have much bearish evidence at present but the markets are over-extended. I, personally, feel good with a limited exposure in no-load funds and a very minimum core position in gold coins. I'm watching the PTI carefully here (remember the P & F chart of the PTI in the last Letter).

BRAKES: When you watch US money action, basically you watch three things. You watch (1) the cost of money, (2) the amount of money in extent, (3) the rate of turnover of money or velocity.

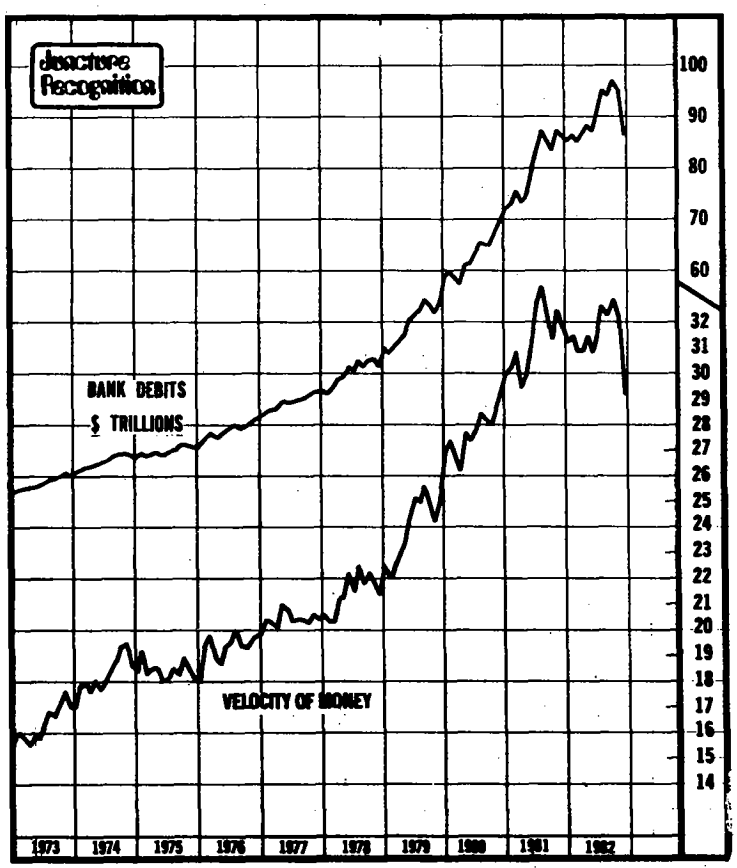
Because of the monster debt load in this nation, it takes more money and more turnover in money to keep the whole economic machine rolling. If money turnover declines, then it requires a larger amount of money to keep the economy going. If the total money supply declines, then it takes more turnover (velocity) to keep the economy going.

The accompanying chart is through the courtesy of *Juncture Recognition,* Box 1209, Pompano Beach, FL 33061. What the chart is showing is the biggest break in money velocity in 40 years. Now the interesting thing about money turnover (which is a measure of how fast people are spending) is that it cannot be manipulated by the President, the Fed, the Treasury or anyone else. When corporations or individuals are confident, they go out and spend. When they are uncertain or frightened, they pull in their spending. When spending is curtailed, obviously money turnover slows. And that action is reflected in the velocity figures.

Friend Lippman of US Organization Chart Service gave me these amazing figures last week. In the three categories of (1) Military aircraft, (2) Missiles and (3) Space (NASA only) the sales growth trend is as follows. There will be sales of $39 billion in 1983. These sales will explode to $64 billion (up 64%) by 1985. From there on spending really explodes. Put it this way–defense spending by the US is heading up, up and away. It's going to be huge. And the impact has not hit yet.

Below is my list of recommended defense-oriented stocks. They should not be bought except as a group of all ten, and I don't care if you buy 10 shares of each or 500 each. But don't buy two or three–buy the package.

		2/25/83 Price	Current Price	
NYSE	Harris Corp. (HRS)	49 1/2	45 1/2	Defense stock average based on 1 share of each this week is 245
NYSE	LFE (LFE)	11 7/8	13 1/8	
NYSE	Planning Research (PLN)	14 3/8	14	
NYSE	Scientific Atlanta (SFA)	19	16 3/8	
NYSE	Tracor (TRR)	28 3/4	31 1/2	
NYSE	Bolt Beranek (BBN)	37	35 1/4	
NYSE	BDM (BDM)	43 1/2	53 1/2	
AMEX	Dynalectron (DYN)	12 3/4	12 3/8	
AMEX	Moog B (MOGB)	15 1/2	16 7/8	
AMEX	Systems Planning (SPZ)	7	6 7/8	
	Original purchase date Feb. 25 '83		239	



Very little is being written about this, but it is certain that the Fed is watching the velocity figures very closely now. And it is obvious that they cannot like what they see. The sharp break in velocity had to scare the Fed, and this (in my opinion) is the reason the Fed has allowed the money supply to run wild since January.

The money velocity statistics may be the most important economic series of the next few months. Of course, no one or two month statistic will tell the whole story, but if velocity continues to plunge– then matters could get out of hand. The story during the rest of 1983 will be told in a single word– confidence. And judging by this velocity chart, confidence better return–and fast.

DEBTS AND DEVALUATIONS: Debts and devaluations will probably be the pass-words of the 1980s. Statistics released a few weeks ago show that the undeveloped nations increased their external debts by an incredible 18% this year to $626 billion. The chances that this debt (or even a large portion of it) will ever be repaid are dubious. It's probably a lot of money down the drain.

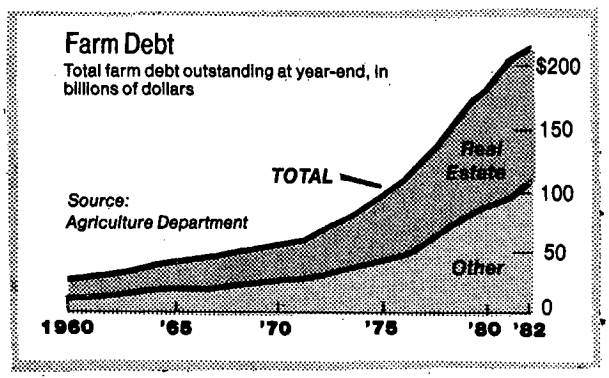
In the meantime, the battle for exports turns "dirty." One way of competing is through devaluation of a nation's currency. Such action makes imports more expensive while rendering the given nation's exports cheaper in world markets. Of course, the net result of a devaluation is that it cheapens a country's currency in world markets and increases the pressure for inflation (since merchants and manufacturers within the country will try to raise their prices to make up for the losses brought on by devaluation).

What will be the outcome of all these deficits, debts and devaluations? More and more I'm of the opinion that we are moving towards massive re-scheduling of international debt. Actually, as far as Mexico, Brazil and Argentina are concerned that's just what we've seen. But the situation becomes even more difficult as nation after nation borrows more money to pay the interest on their debts. Ultimately, the whole structure will collapse, and at that time I would guess that a world moratorium could be declared in an effort to stop a panic run at the banks.

I keep stressing one simple phenomenon: the more the borrowing, the bigger the debt structure. The bigger the debt structure, the higher the cost of servicing. In the absence of hyper-inflation, the debt servicing process breaks down. At that point re-scheduling takes place. When re-scheduling breaks down, we'll see a moratorium. Debts, like stocks, can't "grow to the sky" (actually, the debts are about at the sky-high level now.

> *Special to* THE WALL STREET JOURNAL
>
> PARIS–The total external debt of developing countries will climb 18% this year, to $626 billion, from $530 billion in 1981, the Organization for Economic Cooperation and Development said.
>
> In an annual review, the OECD said the growing debt load of many borrowing nations has been aggravated by rising interest rates, slow trade growth and weak commodity prices.
>
> "For most of the 1970s, the real burden of debt and debt service was being eroded by inflation; it is now being radically increased in the context of economic stagnation," the study said.
>
> The OECD noted a sharp increase in debt-service obligations, due to a growing reliance on commercial bank loans and proliferation of floating-rate loans. Third World borrowers face a crunching debt service that will rise 20% in 1982, to $131.3 billion, according to the OECD study.

NOTES & QUOTES: There are a lot of bright spots and a lot of black spots in the US economy. One of the black spots is farming. This chart shows the great build-up in farm debt since the 1960s. But the problem is supporting and paying off this debt. Farm prices are weak, very weak. The CRB Commodity Index (27 commodities not including gold) is just 10 points off its 1982-83 low. The price of farm land has eroded, and farm-oriented banks are starting to write off many of their loans as uncollectible.



* *

Long-time auto student and writer Brock Yates has come out with a fascinating book entitled, "The Decline and Fall of the American Automobile Industry" (Empire Books, $13.95). Yates ascribes the demise of the US auto industry to two main causes: (1) The replacement of innovative, imaginative auto executives by penny-pinching "bean counting financial types" from the nation's top business schools. (2) The isolation of white, Anglo Protestant auto executives in an ivory tower world of surburban, fadless, up-tight Detroit. These executives laughed off the invasion of foreign cars, believing they were non-Detroit nonsense cars that were being sold to West Coast crackpots and foreign-car snobs.

Yates lists what he considers (for various reasons) the ten best and worst cars ever built. The best: the Mercedes-Benz 123 series, model 300RD, Toyota Corolla, Honda Accord, Audi 5000s, Honda Civic, SAAB 900, APC Turbo, Ford Escort and the identical Mercury Lynx, Olds Cutlass and its twin Buick Regal, Jaguar XJ6, Mazda 626. His list of the ten worst are: Renault LeCar, BMW 320, Rolls Royce Silver Spur, GM's J cars, Renault's 18i, Chrysler Imperial, Cadillac Seville, Nissan's Datsun Sentra, Peugeot 504, Lincoln Town Car-Mark VI.

* *

Veteran readers of these Letters know my feelings about gambling. My position is that the constant gambler is suffering from the financial counter-part to heroin addiction. But I won't say that gambling isn't fascinating. It can be (if you don't mind going broke). The March 7 and 14 issues of the New Yorker magazine had a great article on Las Vegas, and I just couldn't

put the issues down until I finished those pieces. I include below excerpts from the articles (if you think you're a poker champ, the article is must reading).

FOR the talented, Jack Binion is fond of saying, Las Vegas is the land of milk and honey, and for the rest it is a burial ground. Perhaps that is one way of explaining the prodigious crime rate, which the local papers find harder to disguise than to report. All the losers in the world come to Vegas in the hope of changing their luck; but losers are losers wherever they go, and eventually they become desperate. Hence the muggings, the violence, the theft. Hence, too, the depression. When the regulars in the low-limit games are going well, they earn pocket money and try to persuade themselves that they are making a living. Most of them are good enough to know the probabilities of filling a hand and to calculate automatically the odds offered by every pot. And because the ante is small they can sit for hour after hour waiting for bombproof cards. This gives them a tremendous advantage over impatient visiting tourists. But it is not enough to beat the house rake—the few dollars taken by the casino from every pot, which chips away like a stonemason at winners and losers alike.

So the intelligent, educated outsider can persuade himself that he is in with a chance, particularly since there is an element of luck in any card game. Chess is a game of pure information—like poker with all the cards exposed—where the better player will always win; that is why a computer can be programmed to play it so well. But the only way a computer could be made to play top-level poker would be by introducing a randomizing factor into the program which would correspond both to the element of bluff and to the random way the cards fall. When the cards are particularly kind, even a sucker can beat a really good player. But not for long. That is why the poker tables at Las Vegas are called "the graveyards of home-town champs." Poker players who have beaten their local games in all corners of the world come to Vegas to test their skills, like tennis players converging on Wimbledon. Nearly all of them go home broke.

* *

More on US and Russian defense: One of the things that people do not understand is that the key to defense (new weapon systems) is research and development. Without R & D a nation will be producing last year's weapons next year and the year after. In view of this, the following item from the March 7 Christian Science Monitor is of interest.

What CIA and DIA officials stress (and what will be emphasized in the Soviet Military Power report this week) is that there has been no slowdown in key aspects of Soviet military *investment*. This includes research, development, and construction of weapons production facilities. While the two agencies are not always in agreement, both say the Soviet Union is spending about 70 percent more than the US on military R&D.

"That's a frightening gap," says one specialist. "The Soviet defense establishment is still very intact, still very much healthy.

"Their production facilities have been expanding rapidly, especially in the past few years. It may indicate that there will be a new burst of production in the next few years. That's what we're trying to figure out."

I just received an advance copy of a new book by my friend, Kiril Sokoloff and name-economist A. Gary Shilling. The title is most significant. It is called, "Is Inflation Ending? Are You Ready?" The book (McGraw Hill) is scheduled to be published next month. This is perhaps the first book to be published by a big name-economist in which the economist places his bets on the deflation scenario. The authors give many reasons why they believe inflation is essentially over–and what you can do to survive no-inflation.

* *

A few months ago I wrote about my new Kloss "Novabeam 1," the giant projection TV that I bought (the screen is 6.5 feet, diagonally). In the few months that I've had the Kloss I've come to two conclusions: (1) this machine is one of the most gratifying things I've ever bought. (2) Large screen TV is the wave of the future. The fact is that whether you see the news, a movie or a documentary on the Kloss, everything has a totally different dimension. Friends who watch this big screen are delighted. It's like a motion picture theatre in your own home. So far, Kloss is the ONLY manufacturer to bring out the color, brilliance and clarity on a giant screen. And wonder of wonders, Kloss is a US company!

GOLD: Let's take all the guesses and hopes and wishes out of the gold equasion. Let's turn to two of my most basic technical studies. The first is the 13-week rate of change for

(cont. on pg. 6)

LATE NOTES: Despite all advanced notices, despite almost universal announcements to the effect that the market is "overbought," despite a very high percentage of bullish investment advisors, the stock market appears very reluctant to go down (much less fall apart). The resistance can be gauged by the PTI readings for the last three Fridays. On March 4 the PTI was 1542, on March 11 it was 1541, on March 18 it was 1538. This represents a loss of 4 points during three weeks of "corrective action." There may be more downside to come, perhaps a lot more, but so far the PTI readings show great resistance to the decline.

The short-term rates are definitely firming now with last week's 91-day Treasury bills leaping to yields of 8.65. Ordinarily this would put pressure on the stock market, and I'm interested to see whether the downside resistance will last.

I hope that most subscribers have taken the bulk of their positions in the recommended ten defense-oriented issues (see page 3). These stocks were carefully selected, and most of them should be in line for huge defense contract awards. I don't think the extent of the forthcoming defense build-up has been fully appreciated by either the public or the Wall Street analysts. Many companies will be in line for multiple contract awards that will amount to billions (yes, I said billions) of dollars. These awards will strain the productive capacities of many of the companies–even the larger ones.

gold–often called momentum. Included here is my chart of gold momentum going back to August, 1981. What we see is a trendline in gold bullion (average of the daily 2nd London fixes), a trendline extending back to June, 1983. Over the past three weeks this trendline was decisively penetrated to the downside.

Below this we see the momentum index. I have drawn a long rising trendline going back to May, 1982. This trendline was decisively broken during March. Both of these studies add up to a bearish prognosis for gold.

Now turn to the three moving averages of gold. This is a fairly simplistic study–but it is a basic one–and over the years I have found it to be of great help. As of last week the 50-week or primary trend moving average was at 427. The 13-week or intermediate MA was at 454, and the 5-week or short-term MA was at 438. Thus, we note that the 5-week MA was holding below the 13-week MA first sell signal, and the 13-week MA was still 38 points above the 50-week MA (not yet a major sell signal). But the spot price of gold is now below all three moving averages, and this is a definite negative.

A third study is the ratio of gold to common stocks (common stocks as represented by the NYSE Composite). As of last week the ratio had dropped to its lowest level (in favor of stocks and against gold) since 1979. This is a poor and deteriorating background for gold and constitutes another obvious negative in the gold picture (gold seldom does well when this ratio is moving down in favor of common stock over gold).

From still another point, gold shows weakness. The bear market drop from 850 to 300
produced a point loss of 550. A 50% retracement would have produced a rally to 575. But the gold rise halted just above 500, a weak performance. Then gold plunged from 508 to 400. A 50% retracement of that panic-drop would have taken gold back to 458. But the gold rally stopped in the mid-430s, another weak performance. I would think that gold would now retest the 400 level again. If 400 breaks, I look for 350-380.

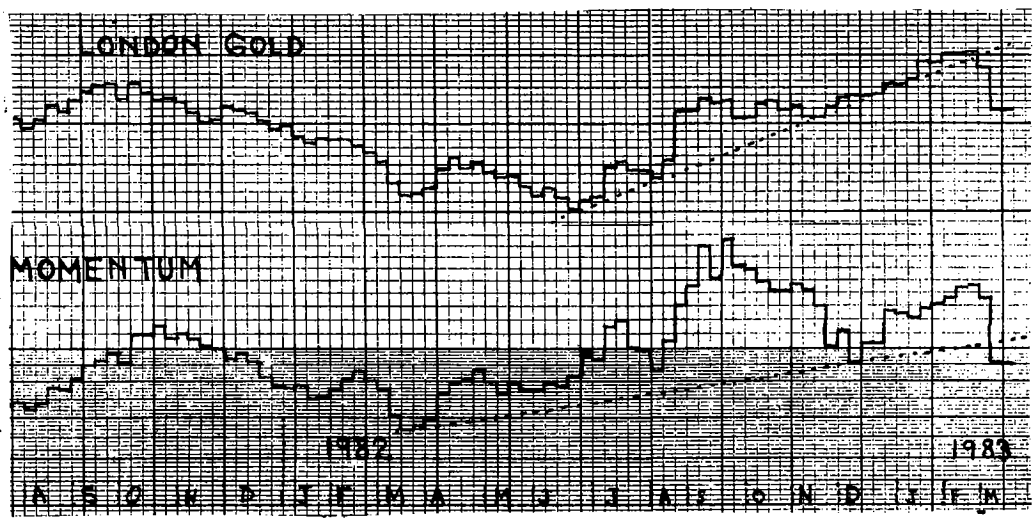
The psychology for gold is dubious now. I say this because every gold letter is calling this "a great gold-buying area", and they are all saying that we have seen a panic in a continuing bull market. Not a good background for a recovery.

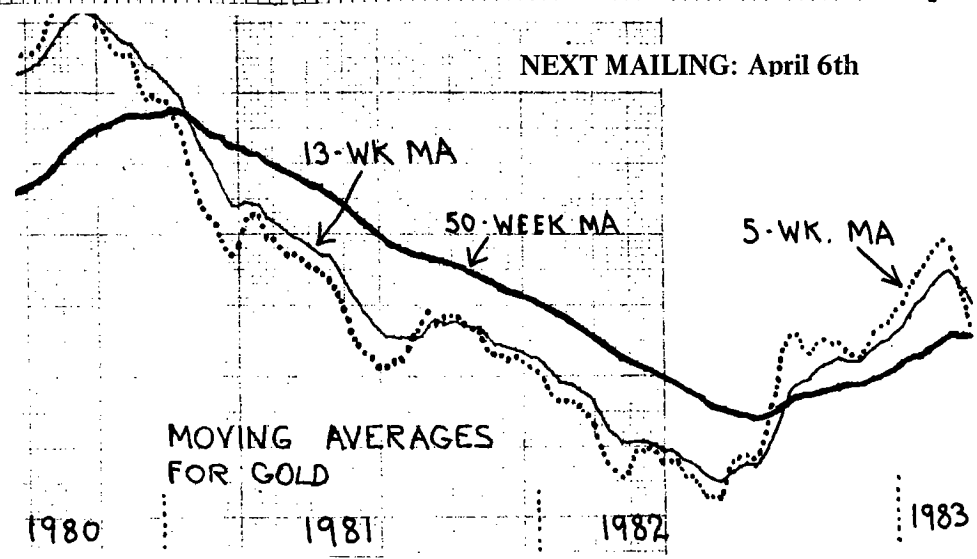
Finally, I note that the adjusted monetary base for the four weeks ending January 12 was 18.2%, a whopping monetary explosion. But even this did not propel gold skyward.

So what's happening? We all know about the oil weakness, and we have known about it for months. So we really can't blame oil. Personally, I think its the debt and deficits that are putting the pressure on gold. Despite the huge monetary build-up (which is inflationary), the rising mountain of debts is deflationary. The result could be a stand-off in the economy at least for a year or two or even longer. But an inflation-deflation stand-off is hardly enough to send gold higher. And maybe that's the problem now (although the same stand-off would be a plus for the stock market).

And then comes the unthinkable for the hard money camp. Could this be a bear market in gold? I think it could be. With that dreaded thought I guess I stand almost alone.

	Dow	PTI	Gold
Current	1117		421
5-wk MA	1119		438
13-wk MA	1086		454
50-wk MA	984		427
3-wk MA		1536	
8-wk MA		1509	
21-wk MA		1451	





NEXT MAILING: April 6th